

Resource 1 (1 of 2)**A Story of the Federal Reserve, 2006**

Federal Reserve Vice Chairman Donald L. Kohn summarized the history of the Federal Reserve in a speech to the American Bar Association in 2006.

Vice Chairman Donald L. Kohn

At the American Bar Association, Banking Law Section, Washington, D.C.

November 3, 2006

The Evolving Role of the Federal Reserve Banks

I am pleased to have the opportunity to speak to this group of lawyers who practice in the banking area. As banking lawyers are well aware, the Federal Reserve embodies a unique legal structure compared with other central banks around the world. Unlike the Bank of England, for example, the Federal Reserve is not a single entity, but a decentralized system. The essential components are the Board of Governors, a federal government agency, and the twelve regional Federal Reserve Banks, which are structured essentially as private corporations.

This structure has served the nation exceptionally well over the years. In the past decade or so, however, the emergence of nationwide banking systems, significant changes in the nation's payments systems, technological advances, and other developments have prompted changes in the ways in which we meet our responsibilities,

The Existing Structure of the Federal Reserve System

The current structure of the Federal Reserve—the combination of a centralized government agency and regional corporate Reserve Banks—is the product of a carefully crafted political compromise. In the early years of our nation, the First and Second Banks of the United States performed many basic central banking services. These were banks that, while chartered by Congress, were owned and managed by private, nongovernmental interests. Their charters, however, were allowed to expire, and their demise has been attributed to deep-seated opposition in some parts of the country to the centralization and concentration of economic power.

As the nation grew through the nineteenth and early twentieth centuries, it lacked any entity that was constituted to carry out the basic roles of a central bank. However, after a financial panic in 1907 forced a number of banks to close, disrupting the economy, a consensus emerged that the nation needed some form of central bank, and Congress created the National Monetary Commission. The commission, chaired by Rhode Island senator Nelson Aldrich, called for one central institution, with fifteen branches across the country, to issue currency and discount commercial paper. However, thirty-nine of the institution's forty-two-member board of directors would be bankers, which aroused the long-standing fear of some about the concentration of economic power in the hands of a few large banks. Agrarian and progressive interests, led by William Jennings Bryan, favored a central bank under public, rather than banker, control. But the vast majority of the nation's bankers, concerned about government intervention in the banking business, opposed a central bank structure directed by political appointees.

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The legislation that Congress ultimately adopted in 1913 reflected a hard-fought battle to balance these two competing views and created the hybrid public-private, centralized-decentralized structure that we have today. A centralized governmental Federal Reserve Board, with members appointed by the President and confirmed by the Senate, exercises general oversight over the Federal Reserve System and works with the Reserve Banks to determine policies to fulfill the Federal Reserve's legislative mandates. The Reserve Banks were intended to be "banker's banks" and to carry out the operational functions of a central bank. Additional duties were assigned to them as a result of subsequent developments [but]. . . the Reserve Banks are structured to carry out public policy objectives set in the Federal Reserve Act, not to advance the interests of their shareholders.

Source: Board of Governors of the Federal Reserve System, (2006, November 3). The evolving role of the Federal Reserve banks. Retrieved from <http://www.federalreserve.gov/newsevents/speech/kohn20061103a.htm>

Questions to Consider:

- ▶ Who is Donald Kohn?
- ▶ What do you notice about the way in which he tells the story of the Federal Reserve?
- ▶ Kohn was writing in 2006. Would this story have been written differently in 2008? Or 2016?
- ▶ How might a critic of the Federal Reserve tell this story? (See Ron Paul quotation in Resource 4.)